

REPORT OF THE PENNICHUCK WATER SPECIAL COMMITTEE

APRIL 19, 2016

A meeting of the Pennichuck Water Special Committee was held on Tuesday, April 19, 2016, at 7:00 p.m. in the Aldermanic Chamber.

Alderman-at-Large Daniel T. Moriarty, Chair, presided.

Members of the Committee present: Alderman Sean M. McGuinness, Vice Chair
Alderman-at-Large Mark S. Cookson
Alderman-at-Large David W. Deane
Alderwoman Mary Ann Melizzi-Golja

ELECTION OF COMMITTEE CLERK

MOTION BY ALDERWOMAN MELIZZI-GOLJA TO NOMINATE ALDERMAN MCGUINNESS AS THE COMMITTEE CLERK FOR THE 2016-2017 TERM

MOTION BY ALDERMAN COOKSON TO CLOSE THE NOMINATIONS
MOTION CARRIED

VOTE ON ALDERMAN MCGUINNESS AS COMMITTEE CLERK FOR THE ENSUING TERM
MOTION CARRIED

PUBLIC COMMENT - None

COMMUNICATIONS

From: Larry D. Goodhue, Chief Executive Officer, Pennichuck Corporation
Re: Annual Meeting of Sole Shareholder
• Referred to Cmte – 4/12/16

MOTION BY ALDERMAN DEANE TO ACCEPT, PLACE ON FILE AND RECOMMEND THE ELECTION OF C. GEORGE BOWER, JAY N. LUSTIG, JOHN D. McGRATH AND PRESTON J. STANLEY, JR., TO THE BOARD OF DIRECTORS OF THE PENNICHUCK CORPORATION EACH FOR A THREE YEAR TERM, AND UNTIL THEIR SUCCESSORS ARE ELECTED AND QUALIFIED

ON THE QUESTION

Chairman Moriarty

There are three things that we get every year, a notice of the annual meeting of the sole shareholder, a proxy card and the annual report. In summary there is only one thing on the proxy card this year.

Thomas J. Leonard, Chairman of the Board of Directors, Pennichuck Corporation

As Chairman of the Board of Directors this is primarily from the Board of Directors in many regards. It is our normal process for our annual meeting. The annual meeting is set for May 7th at 9:00 a.m. at the Courtyard Marriott. This is all with regard to getting ready for that. The first thing you have is the annual notice and then the proxy card which shows the four individuals that we have nominated. We have a total of eleven directors and these are four that are presently on the Board and they are up for re-election. You and your committee

and your Board will name somebody to fill out the proxy card. The third thing is the annual report which is the financial statement.

Alderman Deane

Item #1 is taken care of. WE know that the meeting is going to be held on May 7, 2016, at 9:00 a.m. at the Courtyard Marriott, 2200 Southwood Drive, Nashua, NH and its open to the general public. Now we need a motion to send back to our full Board the recommendations on the proxy, is that correct?

Chairman Moriarty

Yes, there is an ordinance that I am proud to have had submitted several years ago that just by way of review, the City of Nashua owns Pennichuck and the mechanics of filling out the proxy, the Board of Aldermen has to accept its first reading and then come to this committee and interview people we want to and make the recommendation to go back to the full Board and the full Board has to vote on the proxy card and then the Mayor signs it.

Alderman Deane

Okay so we understand the process.

MOTION BY ALDERMAN DEANE TO ACCEPT THE PROPOSAL TO ELECT C. GEORGE BOWER, JAY N. LUSTIG, JOHN D. McGRATH AND PRESTON J. STANLEY, JR., TO THE BOARD OF DIRECTORS OF THE PENNICHUCK CORPORATION EACH FOR A THREE YEAR TERM, AND UNTIL THEIR SUCCESSORS ARE ELECTED AND QUALIFIED

ON THE QUESTION

Alderman Cookson

I am familiar with three of the individuals; Mr. Lustig, Mr. McGrath and Mr. Stanley. Mr. Bower is a newer individual as part of the Merrimack Valley. How long has he been on the Board?

Mr. Leonard

About one year. He served an abbreviated term pending re-election at this time.

Alderman Cookson

At the last Merrimack Valley Water District meeting they made a motion for him to be the representative for that Body.

Mr. Leonard

We take a nomination from the Merrimack Valley Board and then we treat that nomination in the same way we would treat any other nomination before our Board. That means it goes to committee and we do our thing and then it goes to the full Board. We did go through that process.

Alderman Cookson

So your nominating committee is in agreement that Mr. Bower should continue on the Board of Directors and he's got a background which is well suited for this Board as well?

Mr. Leonard

Yes.

Alderman Deane

Since Dr. Bower has come up I think we should at least let the public know his background. Dr. Bower has been the principle of ESRA Consulting, LLC. a professional consulting practice concentrated on the development of safety, health and environmental programs from 1994 to present. From 1992 to 1994, Dr. Bower was the president of National Soils, Inc., an applied technology company specializing in the development, management of industrial facilities and waste treatment operations. He was the senior associate chief scientist for Environmental Science and Engineering, Inc. from 1988 to 1992. Dr. Bower holds a Bachelor of Science Degree from Lock Haven University, a Master's Degree in transportation safety from the University of Central Missouri and a Ph.D. from Michigan State University. He is very qualified and I think the whole process with all of the discussion that went on yielded little or no problems. Everyone is happy.

Chairman Moriarty

To further give credit to the Pennichuck Board of Directors, I think the technicality was that Merrimack Valley Water District actually lost their opportunity to make the nomination because they waited too long and then that first step position came up for re-nomination so the way it is written now they actually...you honored that in principle and they had a great candidate but because there was a subtlety between that initial Board of Directors versus a renewal, can you remind us of how that went?

Mr. Leonard

We agreed to accept their nomination without trying to figure out all of the difficulties. Dr. Bower was a good nomination and everybody knew it so we treated it as their first nomination. We are now in order and in the standard process and everything is working fine.

Chairman Moriarty

So from now on the four people will come up and if somebody leaves, if Dr. Bower were to decide to retire, the person who takes his place is not nominated by Merrimack Valley Water District.

Mr. Leonard

Yes, that person is nominated by the Merrimack Valley Water District. With Dr. Bower alone, he is the only candidate; his nomination initiates and comes from Merrimack Valley Regional Water District. There Board would make a nomination and it goes to our Board which in the ordinary course handles it in the committee, the committee makes a recommendation then to the Board and the Board makes a recommendation to this committee and then to the City of Nashua. It's like an additional step coming from Merrimack Valley Water District.

Chairman Moriarty

It will always be that way.

Mr. Leonard

That's correct.

Chairman Moriarty

I know Jay Lustig but I didn't realize he was associated with Scientific Solutions so he has some high-tech background and financial management. John McGrath works for Methuen Construction Company. On their website they have a picture of a crest gate dam; did they actually build the dam here in the city at Jackson Falls?

Alderman Deane

Methuen Construction has done a lot of work in the City of Nashua.

Chairman Moriarty

Preston Stanley, a lot of people know him because he's from Stanley Iron Works.

Alderman Deane

Yes, located on Taylor Street.

Chairman Moriarty

I wish Dr. Bower were here because his resume was pretty amazing. It's an impressive group of people and they have my full support.

Alderman McGuinness

I used to work for Preston years ago at the iron works.

MOTION CARRIED

Mr. Larry Goodhue, Chief Executive Officer, Pennichuck Corporation

The report is submitted in two parts. The front part is the Annual Report to Shareholder and as an attachment to that is our Annual Audited Financial Statements for the consolidated corporation. As the Board is aware we have an annual audit done. Melanson-Heath is our auditing firm and they have been since year end of 2012. On page three you can see the revenue levels that were generated in 2015 at \$40.8 million, up \$2 million from the previous year and that's really emblematic of the fact that we had a very dry summer last year. Consumption levels were at or above normal average levels based on irrigation usage of water. There are a certain amount of operating expenses that do vary along with that but on balance earnings before interest tax, depreciation, amortization or EBITA, at a level of \$15.4 million for the year which was roughly equivalent to the \$15.2 million for the year before. There were no real significant differences; the only one difference is that we did have a large water contract that was approved relative to some water being sold in our Pennichuck Water Works System going forward. There's about ¼ of a million dollars in incremental revenue that started in 2015 and will be in the going forward numbers.

Chairman Moriarty

So the year-to-date revenues are \$40.8 million, what are the total revenues for the year?

Mr. Goodhue

That would be that, this is for the 12 months ended. We are a calendar year corporation. If you look at the cash flow statement on page 5 you start with a net loss but that's on an accrual basis and if you go down about a half of dozen lines it says Net Cash Provided by or Used in Operating Activities, that's almost a proxy for the cash basis as you add back depreciation, amortization, deferred taxes and the changes in certain assets and liabilities. So for the year about \$6.56 million was generated in operating activities. During the year we invested about \$6.5 million net into the company, \$14 million of property plant and equipment that was added and the \$20 million related to a bond re-financing that we accomplished during the early part of the year and then later in the year relative to bonding that we did in late 2014 and 2015. That relates directly to the payments on long-term debt of \$42 million. Those kind of go hand in glove, the \$20 million up near the middle of the page and the \$42 million at the bottom of the page relative to the refinancing activity. Then we had a proceed on long-term borrowings of \$28 million, which relates to the actual bonding activities that we did complete within the year 2015 and as well as the monies that came in relative to other net borrowings. The end of the year had about \$1.2 million in operating cash on the balance sheet. Page 6 shows the assets and the corporation remain above a level of \$300 million of which 60% of that is in property plant equipment. We've got \$183 million worth of fixed assets via a very capital intensive company. We also have restricted cash on our books of \$5.7 million and that has to do with the Rate Stabilization Fund, which is the debt service reserve fund that was established that secures the payments to the city under the city's ownership of the company and the repayment of the debt obligation under the CBFRR. We do have almost \$20 million sitting in investments at the end of the year and that is the money from both the 2014 and 2015 bonding that were monies that had not yet been spent but we had raised those bonds and then utilized for capital projects for those eligible projects, including the construction of our new operations facility next to the water treatment plant in Merrimack and then also capital projects on a whole host of items that are being completed during 2016 and early 2017. MARA is included in the \$77 million number in the middle of the page. That is net of the amortization that has occurred life to date from January 25, 2012. On the other side of the balance sheet you'll see that we've got \$206 million of aggregate bonds, notes and mortgages plus \$4 million of current portion so you can take \$210 million in debt which includes about \$120 million just south of that, maybe \$118 million which is the remaining balance on the note payable to the city from the transaction of purchasing the company and also includes the debt that was on the books at the time the city acquired us plus the additional bonded debt and other debt that we have incurred since that time. We invest on an on-going basis in the replacement of aging infrastructure within the water system to make sure that we are maintaining our core objectives to supply clean water to our customers. These are the major capital projects that were accomplished during 2015, some of which are 100% complete and some of which have carried over to this year for final completion.

Alderman Deane

Does the city inspect the street work that is done?

Mr. Don Ware, Chief Operating Officer, Pennichuck Corporation

Yes, when we do work in the city we do a standard city street opening permit which has stipulations as to what we need to do relative to traffic control and street repair. The street inspectors come out at the end and always make sure that the repairs are in accordance with the permit.

Alderman Deane

So that's all streets?

Mr. Ware

Yes.

Alderman Deane

It was a tough job but when you see the corner of Main and Allds and there is a wide open hole; people in the hole with no trench box and no police cruiser on that corner, that's...

Mr. Ware

I would agree, David, specs call out for anything over 5' you have to have a trench box and usually traffic control is usually one of the things that is specific to the city street opening permit. Generally any work on Main Street requires the city policemen to carry out the traffic control.

Alderman Deane

When you get a street opening permit and you do your work, before it's backfilled and everything it's inspected by....is Pennichuck now exempt from that type of inspection.

Mr. Ware

No, so backfill; normally they are there when we are putting in the underlying gravel, there has to be 24" of gravel; 18".

Chairman Moriarty

So we had the assets of \$310 million so I interpret that as Pennichuck Corporation has a total value in some sense of \$310 million except for the fact that they have \$310 million in debt so the net is zero, is that correct?

Mr. Goodhue

We have \$210 million worth of debt; we also have \$38 million worth of kayak which is an offset to our fixed assets and \$20 million worth of deferred income taxes. Then there is another \$20 million of current and long-term liabilities related to working capital type items and long-term obligations.

Chairman Moriarty

So the acquisition premium is an artificial value, when that ends up going to zero, are you planning to have the company such that when that goes to zero that the total assets would be \$310 million minus the acquisition premium or will you end up having more capital?

Mr. Goodhue

The linkage is between the acquisition premium and the portion of the debt that is tied to the no payable to the city and they come down on the same glide path. In fact the amortization on the MARA is equivalent to the principle repayments of the city's bond obligation. By the time that the MARA is fully amortized the debt to the city will be fully paid off and those are the two pieces that come together. You have more in debt at \$118 million than you do in the MARA and the offsetting piece to that is the equity that was invested in the company when the city acquired us.

Chairman Moriarty

On just the asset side, once the acquisition premium is gone...as time goes on are you going to slowly replace that with property plant equipment?

Mr. Goodhue

Yes because we are investing it at or above the depreciation level on an annual basis so you will have an accretive effect on the net PP&E on the balance sheet.

Alderman Deane

How far behind are we on covering the depreciation or amortization of the capital items that we have?

Mr. Goodhue

I don't understand the question.

Alderman Deane

If you were given an undetermined amount of cash and we had a 12-month building season, how many water lines need to be replaced that aren't being replaced currently?

Mr. Goodhue

We replace about 2 miles worth of pipe per year.

Mr. Ware

It's a little more than that, it's about 2 ½ miles. We are going through our asset management plan and by the way we have done that for as long as I've been here, which is about 20 years. The plan is to stay on top of the aging infrastructure and not to let it reach a point where it's failing and you have emergency repairs on a consistent basis. The goal has always been to maintain the infrastructure and to replace it before it becomes non-viable.

Alderman Deane

So you are going to continue to follow the city around with their sewer replacement work.

Mr. Ware

Yes, and if the city is not doing enough sewer replacement work then we will continue ahead with other projects so that we don't fall behind on the curve. This year we are doing some streets independent of the city's sewer work but in conjunction with the city paving work.

Mr. Goodhue

That's the same process that we use in all of the communities we serve.

Mr. Leonard

From a Board of Directors standpoint we are very aware and wanting to make sure that we don't get behind in the replacement of infrastructure and we don't get caught up in deferred maintenance.

Mr. Goodhue

As we met with the rating agencies one of the questions is what are your policies about infrastructure replacement and making sure that you are maintaining your company at a certain level.

On page 7 you will see a list of the largest capital projects that were undertaken during the years. The Merrimack River Raw Water Main was \$2 million and it's being completed now and sometime during the year it will be connected into the plant. The asset management system, this is year 3 of a 5 to 6 year plan on that. A great deal of work has been put in and some of the tangible benefits that are derived from that system are being experienced at this time. We are now able to respond to our customers and service our customers at a level that didn't exist prior to this system being replaced. We did go through the first round of replacement of carbon filter beds in the Nashua Water Treatment Plant since its upgrade in 2007 and so almost \$1 million was spent last year.

With regard to financing, these are kind of memorializing things that have come before this Board as these things have occurred during the year relative to the bonding activities and the annual draws that we have done with the state revolving fund for various projects at Pennichuck East Utility, Pennichuck Water Works and Pittsfield Aqueduct and also borrowings from CoBank relative to Pennichuck East Utility. It's some of the other activities relative to some filings with the PUC. We have and do have continuing efforts going on relative to succession planning within the company. We had an executive retire this past fall and we re-sorted the organization with regard to that. As a company succession planning is part of our culture. We make sure that we do everything that we can so that we build a team from the bottom up. We have a 3 year rolling training plan when we look at everyone in the company and what their individual training needs are, what the skills are and what their core competencies are. We coach not only vertical succession by lateral and diagonal succession. We had three or four people move up in the organization but across the organization at the same time so there is a cross-breeding of talents.

Alderman Deane

So you have individuals feeling each other pains in different parts of the company. It gives them a better appreciation.

Mr. Goodhue

Yes and now they become an advocate in another department to help have a department understand what happens in other parts of the company and it makes us all better at our jobs.

Alderman Deane

That's awesome, good to hear.

Mr. Leonard

The other thing that I would add is that we have an independent audit that is independent of the manager. The audit is done on behalf of the Board of Directors and the audit committee. The short story is everything came out very good.

Chairman Moriarty

So what we heard from the CFO was the official company finances and the remainder document here is actually from the Board of Directors.

Mr. Leonard

It's a coordinated effort but my point is that the audit is independent of the management.

Mr. Goodhue

That is typical in a normal corporate environment. They are hired by the Board of Directors and their reporting authority is to the Board of Directors. We maintain a normal corporate structure and that's one of the elements in that corporate structure that is maintained.

Chairman Moriarty

A lot of people have been reading in the news two things nationwide. One is the lead problem in Flint, MI and the other one is the perfluorooctanoic acid which is in wells. Have you seen any of the PFOA in your process?

Mr. Goodhue

We have been living with both of those topics for several weeks now. Flint, MI was a situation where based on some decisions that were made relative to changing the water supply from the City of Detroit to the Flint River and then making a decision as to how they were going to treat that raw water caused a situation where the lead service lines wound up leaching lead into the homes of the residents out there and it created quite a situation. Lead is one of the regulated contaminants that we are required to monitor for and test and as a company we are subject to an every three year testing because of our history. You test at a 90% standard and it is 15 parts billion and if 90% of the tests; there's a targeted group; it's a high risk group, its single-family homes built between 1982 and 1986. We have to do a sampling of those homes and as long as 90% of your samples are below that testing level then you are in compliance. Our last samples were done in 2014.

Alderman Deane

When were those years selected?

Mr. Goodhue

That is because that was the highest instance rate of when lead core solder was used in homes and the highest concentration of lead is going to be inside of people's homes; it's going to be in the solder in their pipes and the leaded brass fixtures within their homes. Our last set of tests, and this is part of our customer confidence reporting that we put out to our customers, and if there are any violations or any exceeding amounts that we have to deal with we are fully in compliance with all of the those standards. In fact, the highest sample we have from 2010 was .24 parts per billion as opposed to 15 parts per billion. More germane to us is the situation in north Merrimack that is occurring right now with perfluorooctanoic acid; a word that I never knew existed or knew how to pronounce six weeks ago. We have been in direct contact with the MBD, the DES, the governor's office and indirectly the EPA with regard to this. Merrimack Village District is the primary source of water in that area; there was a press release that was issued on March 7th indicating that Saint-Gobain had found PFOA's in their water system which cause the DES and the MBD to get involved to do testing in their wells. Upon receiving that press release we independently decided that we were going to do some sampling of our own wells in the area and our own water system within the area, out of cycle. This is a testing result that is subject to an annual testing. We drew seven samples from different sites because we do

have two water systems that get part or all of their water from MVD and then we've got a water system that is across the river in Litchfield. We took those sample results and reported them to the DES. We've actually participated in town meetings in both Litchfield and Bedford but we did not participate in the one that was in Merrimack because that was the first one and it was really focused on their own people but we've actually participated in the meetings in Litchfield and in Bedford. We've been in participation with discussions at the DES on a fairly regular basis on this and we've submitted our test results and I am personally responding to every customer call that comes into the company with regard to these questions on a daily basis. We are monitoring the situation. We are actually testing now on a frequent basis with regard to this as the resolutions are being developed between the DES and Saint-Gobain as a potential responsible party, as you have probably read in the press. Our testing results have been made public and they are on our website. We have put some direct communications onto customers in those water systems and we have them that we will continue to post our sampling results on the website and if any significant events occur; i.e. the EPA comes out with a long-term health advisory level, the DES comes out with a state advisory level or standard or there are material developments with regard to Saint-Gobain's response to the demand letter that was issued to them by the DES; we would put out direct communications to our customers. We've gotten some calls from people in Nashua and some calls from other communities. One of the tests results that we did was before and after the water treatment plant; we tested the raw water in the Merrimack River, we tested the water at these two water systems and we actually tested water in Litchfield and the results have been included in the maps that the DES has posted at these sites and is actually on their website.

Mr. Leonard

I'm not sure if it was clear but the systems that Mr. Goodhue is talking about are not the core system for Nashua.

Mr. Goodhue

They are community water systems.

Mr. Leonard

Yes and this whole difficulty is outside of the City of Nashua.

Chairman Moriarty

So is our water clean?

Mr. Goodhue

I'll tell you and this is public information so that is why I will recite the exact results. The sample that we took on March 16th; the entry point and exit point from the water treatment plant in Nashua; the exit point was at 3 parts per trillion. Brendan Kiernan of the DES has said on stage at the various town meetings that that was considered to be what a background level is for this substance. The DES is considering anything below 10 parts per trillion to be a background level, a level that would be found generally in nature because these components or chemicals have been used since the 1940's in various manufacturing applications throughout the world. We also tested, and again this is on the map, we tested the raw water in the Merrimack River at 2.1 parts per trillion. To give you a sense of what a trillion is it's a drop of about the size of the head of pin in 100 Olympic sized swimming pools.

Alderman Deane

So you are all set Dan you can continue to make your orange juice.

Chairman Moriarty

Yes, I think we are okay, we can continue to drink the tap water. Looking at the map that showed where the wells came up tainted, I found it intriguing that it's in Litchfield which is on the other side of the Merrimack River from Saint-Gobain so we think to ourselves water is on surface water and you would almost think that if it were to flow on the surface then it would get in the Merrimack and off it would go. This is clearly a deep problem.

Mr. Goodhue

Mr. Frizie who is the assistant director of the DES indicated in the town meetings in both Bedford and Litchfield that what they have been able to ascertain or they suspect is that this is the result of a chemical called APFO that was stack emissions from Saint-Gobain that were airborne that blows and our wind goes west to east and would deposit in the soil and then work its way into the ground water. The indications are that the mapping that they are seeing is consistent with that thinking.

Chairman Moriarty

So that's a better answer than or a better hypothesis that it's so deep in the ground that it has moved sideways because that would have taken decades for that type of flow to happen and the solution would take forever.

Mr. Goodhue

That is the theory and in fact they revealed some air quality testing results from the stack emissions and they were all compliant with standards that existed at the time relative to Saint-Gobain using their chemicals which they stopped using in 2007. It was a surfactant and it was used as a lubricant and it's used in the manufacturing of Teflon coated pans, gortex, stain resistant carpeting, dental floss and microwave popcorn bags. They have changed to a chemical over there that's a surfactant called C6, which the DES is currently testing for as well just to make sure that they get ahead of the curve.

Chairman Moriarty

It's always good to have you here.

UNFINISHED BUSINESS - None

NEW BUSINESS – None

PUBLIC COMMENT – None

REMARKS BY THE ALDERMEN

Alderman Deane

I'd like to thank everyone for coming and providing great service and doing a stellar job. It's so nice to see a nice Board of Director's too; there are some really great people that serve.

Chairman Moriarty

I'll be a homeowner in a couple of weeks and I have two water meters on my house, why do I have two water meters on my house?

Mr. Ware

There are a couple of potential reasons. Back at a point when the city used to charge sewer based exclusively on your water meter usage but people would water their lawns in the summer and so people were paying for sewerage that wasn't going down the drain so at one point the city allowed people to put in a second meter, it was a deduct meter. People would read it and call it into the city sewer department and then they would deduct that from the water reading that they got for what they were billed for sewer. There were quite a number of people who put in that second meter. A number of years ago the city went from that process and said from now on we are just going to bill you on your average winter usage and people stopped putting second meters in but there are still quite a number of homes, I'm going to guess well over a thousand residential homes at one point that had second meters put in after that first meter so that the homeowner could read it and call up the city and get them to reduce the reading that was coming from the main meter.

Chairman Moriarty

Do I have to do that?

Mr. Ware

Right now what happens is the city sewer department just bills you based on your wintertime usage. They ignore your summer usage.

Alderman Deane

Your note watering your lawn or washing your car or pressure washing your house in the dead of winter.

ADJOURNMENT

MOTION BY ALDERMAN DEANE TO ADJOURN
MOTION CARRIED

The Pennichuck Water Special Committee meeting was adjourned at 7:49 p.m.

Alderman Sean M. McGuinness
Committee Clerk